



UNIVERSITI PUTRA MALAYSIA

**EFFECTS OF INSTITUTION, LEGAL TRADITION AND POLITICAL
FACTORS ON FINANCIAL DEVELOPMENT**

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**EFFECTS OF INSTITUTION, LEGAL TRADITION AND POLITICAL
FACTORS ON FINANCIAL DEVELOPMENT**

By

HATRA VOGHOUEI

Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia
In Fulfilment of the Requirements for the Degree of Doctor of philosophy

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DEDICATION

To my lovely husband, Mohammad Ali Jamali, whose love, patience and assistance has been overwhelmingly supportive throughout. My love goes out to you wholeheartedly.

To my adorable daughter, Artina, whose sacrifices her childhood for me. You are always my ultimate source of inspiration.

To my parents whose their endless love and support throughout my lifewarmed my heart and helped me achieve my goals. Without you, I would not be able to finish this project.

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment of the requirement for degree of Doctor of Philosophy

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Chair: Professor Azali Bin Mohamed, PhD

Faculty: Economics and Management

This study deals with the effect of economic institutions, legal tradition and political factors on variation of financial development over 27 years where these determinants are themselves endogenous and determined by political factors. First, by considering the theory of “economic institution” proposed by Acemoglu et al (2004) this study indicates that two groups of political power (de jure political power or political institution and de facto political power or distribution of resource) determine the economic institutions which are important in variations of financial development. Second, by referring to the theory of “dynamic legal tradition” proposed by Beck et al (2001), it suggests that political factors in countries with different legal adaptability affect legal environments which are important in promoting the financial system. Third, it presents that the political factors directly and indirectly through other determinants of financial development could explain the variation of financial development over the years.

By using the dynamic panel data of 60 countries during 1980-2006, the empirical results showed that de jure political power has more significant effect on financial development

than de facto political power. These outcomes have important policy implications. The emphasis on strengthening de jure political factor through effective mechanism of checks and balance, promoting political competition and free stream of information, will help to put the economic institution in power that promote the development of financial system.

The results support the idea that political power could change the legal environments which are important in development of financial systems. It showed that the political factors that promote shareholder rights and investor protection respectively could promote financial system more than the other factors. The results also showed that the effect of political changes on financial development in common law countries is more than this effect in German law countries.

Finally, the results clarified that the development in financial system positively responds to variation of political variables. It showed that when the direct effect of political factors is considered the political stability has more effect on financial development than the other factors. Moreover, when the direct effect alongside the indirect effects through other determinants are considered, political stability has more impact in development of banking sector though, the effect of political competition on development of stock market is more than the others. Thus, different aspects of political factors which have positive effect on financial development could be used as policymakers' tools in order to achieve more financial development and hence economic growth.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

**PENGARUH INSTITUSI KEWANGAN, TRADISI UNDANG-UNDANG DAN
FAKTOR- FAKTOR POLITIK KEPADA PEMBANGUNAN KEWANGAN**

Oleh

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Penyelidikan adalah mengenai pengaruh institusi kewangan, tradisi undang-undang dan faktor-faktor politik kepada variasi pembangunan kewangan yang lebih dari 27 tahun di mana faktor penentu itu sendiri endogen dan ditentukan oleh faktor-faktor politik. Pertama, dengan mempertimbangkan teori "institusi kewangan" yang dikemukakan oleh Acemoglu et.al (2004), kajian ini menunjukkan bahawa dua kuasa politik (kuasa politik atau institusi politik dan kuasa politik atau pengedaran sumber) menentukan institusi kewangan yang penting dalam variasi pembangunan kewangan. Kedua, dengan merujuk kepada teori "tradisi undang-undang dinamik" yang dicadangkan oleh Beck et al (2001), hal ini menunjukkan bahawa faktor-faktor politik dalam negara mempunyai kemampuan menyesuaikan diri yang berbeza dalam mempengaruhi persekitaran undang-undang bagi meningkatkan sistem kewangan. Ketiga, menyatakan bahawa faktor-faktor politik secara langsung dan tidak langsung melalui penentu-penentu lain terhadap pembangunan kewangan dapat menjelaskan variasi pembangunan kewangan selama bertahun-tahun.

Berdasarkan penggunaan panel data dinamik dari 60 negara selama 1980-2006, hasil empirik menunjukkan bahawa kuasa politik mempunyai pengaruh yang lebih ketara

terhadap pembangunan kewangan daripada kuasa politik. Dapatan kajian ini mempunyai kesanpolisi yang penting. Penekanan terhadapkekuatan faktor politik melalui mekanisme yang berkesan iaitu keseimbangan (check and balance), mempromosikan persaingan politik dan penyebaran maklumat secara bebas, akan membantu mempromosikan kekuatan institusi ekonomi dalamsistem pembangunan kewangan.

Dapatan ini menyokong idea bahawa kuasa politik boleh mengubah persekitaran undang-undang yang mana penting dalam pembangunan sistem kewangan. Hal ini menunjukkan bahawa faktor politik yang mempromosikan hak-hak pemegang saham dan perlindungan kepada pelabur boleh mempromosikan sistem kewangan lebih daripada faktor-faktor lain. Dapatan kajian ini juga menunjukkan bahawa pengaruh perubahan politik terhadap perkembangan kewangan di negara-negara yang mempunyai undang-undang umum lebih berkesan berbanding undang-undang di Jerman.

Kesimpulan, kajian menjelaskan bahawa perkembangan dalam sistem kewangan memberikan tindakbalas yang positif terhadap variasi pembolehubah politik. Hal ini menunjukkan bahawa pengaruh secara langsung terhadap faktor-faktor politik dianggap mempunyai kestabilan politik terhadap pembangunan kewangan lebih berkesan daripada faktor-faktor lain. Selain itu, kesan secara langsung dan kesan secara tidak langsung melalui faktor penentu yang lain dianggap, mempunyai kestabilan politik yang lebih berkesan dalam pembangunan sektor perbankan, walaupun pengaruh persaingan politik dalam pembangunan pasaran saham lebih daripada yang lain. Oleh yang demikian, aspek yang berbeza daripada faktor-faktor politik mempunyai pengaruh yang positif kepada perkembangan kewangan boleh digunakan sebagai alat pembuat dasar untuk mencapai pembangunan kewangan yang mantapbagi meningkatkan pertumbuhan ekonomi.

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I certify that a Thesis Examination Committee has met on 17 August 2010 to conduct the final examination of Hatra Voghouei on his PhD thesis entitled “The effect of institution, legal tradition and political factors on financial development” in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the degree of Doctor of Philosophy.

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DECLARATION

I declare that the thesis is my original work except for quotations and citations, which have been duly acknowledged. I also declare that it has not been previously, and is not concurrently, submitted for any other degree at Universiti Putra Malaysia or at any other institution.

HATRA VOGHUEI

Date: 17 August 2010

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